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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF CHAPARRAL CITY WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO. W-02113A-07-0551

CHAPARRAL CITY WATER COMPANY, INC.

REPLY BRIEF

(RATE BASE, INCOME STATEMENT AND RATE DESIGN)

FEBRUARY 13, 2009

Arizona Corporation Commission
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TABLE OF CONTENTS

CHAPARRAL CITY WATER COMPANY, INC.
PRE-FILED TESTIMONY

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Direct Testimony of Robert N. Hanford	**A-1**	Hanford Dt.
Rebuttal Testimony of Robert N. Hanford	**A-2**	Hanford Rb.
Direct Testimony (Rate Base) of Thomas J. Bourassa	**A-3**	Bourassa Dt.
Supplemental Testimony (Rate Base) of Thomas J. Bourassa	**A-4**	Bourassa Supp. Dt.
Rebuttal Testimony (Rate Base) of Thomas J. Bourassa	**A-5**	Bourassa Rb.
Supplemental Rebuttal Testimony (Lower Income Tariff) of Thomas J. Bourassa	**A-6**	Bourassa Supp. Rb.
Rejoinder Testimony of Thomas J. Bourassa	**A-7**	Bourassa Rj.
Rebuttal Testimony of Robert J. Sprowls	**A-8**	Sprowls Rb.

RESIDENTIAL UTILITY CONSUMER OFFICE
PRE-FILED TESTIMONY

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Direct Testimony of William Rigsby	**R-6**	Rigsby Dt.
Surrebuttal Testimony of William Rigsby	**R-7**	Rigsby Sb.
Direct Testimony of Timothy Coley	**R-8**	Coley Dt.
Surrebuttal Testimony of Timothy Coley	**R-9**	Coley Sb.

STAFF
PRE-FILED TESTIMONY

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Direct Testimony of Marlin Scott, Jr.	S-1	Scott Dt.
Direct Testimony of Marvin Millsap	S-2	Millsap Dt.
Surrebuttal Testimony of Marvin Millsap	S-3	Millsap Sb.

OTHER PORTIONS OF THE RECORD

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Hearing Transcript		Tr.

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Chaparral City hereby files its reply brief concerning the issues in dispute in this case with respect to rate base, income statement and rate design.[1]

I. REPLY REGARDING ISSUES IN DISPUTE WITH STAFF

A. Rate Base.

1. Working Capital.

Staff argues that it is inappropriate to consider any component of working capital in this case because "the Company" did not prepare a lead-lag study.[2] Consequently, Staff recommends a reduction to rate base equal to $631,016, which adjustment consists of removal of Prepayments in the amount of $192,485, Materials and Supplies of $14,521, and Unamortized Debt Issuance Costs of $424,010. Staff's position suffers from two fatal flaws.

First, there is no requirement that the Company prepare a lead-lag study as part of its rate filing. But, RUCO did prepare a lead-lag study. Based on this, RUCO recommended a negative working capital allowance, a reduction to rate base that the Company adopted.[3] Staff's witness ignored RUCO's lead-lag study, apparently because he did not prepare the study himself.[4] Such testimony undermines Staff's assertion that the Company must prepare a lead-lag study in order for the Commission to address working capital. As Staff's justification for its "working capital" adjustment is the lack of a lead-lag study, and the record contains a lead-lag study that went unchallenged, Staff's "working capital" adjustment lacks any basis and should be rejected.

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[1] In this reply brief, the same citation format, abbreviations and conventions as utilized in its reply brief dated January 28, 2009 apply.

[2] Staff Br. at 4-5.

[3] Bourassa Rb. at 12.

[4] Tr. at 380.

Second, Unamortized Debt Issuance Costs have no relationship to working capital. Accordingly, Staff's witness admitted that he mistakenly included these costs in his working capital adjustment, overstating his reduction to rate base to account for working capital by $424,010. No evidence was presented that these costs were improper or otherwise unreasonable; nevertheless, after admitting his error, Mr. Millsap asserted that these costs should be absorbed by Chaparral City's shareholders.[5] This is nonsensical. If the debt is approved and incurred to build plant that is in rate base, there is no basis to preclude the Company from recovering the costs of obtaining such debt.

It follows that Staff's working capital recommendation, and Staff's more than $600,000 reduction to rate base, should be rejected.

2. Staff's Adjustment to Accumulated Depreciation.

For starters, Staff's recommendation that Chaparral City use the Group Depreciation method is surprising.[6] The Company already uses the Group Depreciation method.[7] Additionally, Staff asserts that its adjustment to accumulated depreciation is correct because the transportation equipment it seeks to exclude from the General Office plant in the General Office Allocation was not fully depreciated.[8] Again, Staff is wrong. The General Office vehicles were fully depreciated.[9] Moreover, transportation equipment is an asset group. The group depreciation method does not facilitate identifying accumulated depreciation on specific assets because the asset class is depreciated as a group, not on a specific asset basis.

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[5] Tr. at 376.

[6] Staff Br. at 6.

[7] Tr. at 151.

[8] Staff Br. at 6.

[9] Bourassa Rb. at 11.

Finally, Staff proposes use of a 4.0 percent allocation factor for the General Office Allocation.[10] As Staff correctly notes, the 4.0 percent allocation factor is more correctly matched to the test year than the 2.8 percent allocation factor proposed by RUCO and accepted by the Company.[11] RUCO proposed the use of the 2.8 percent allocation factor because it is a more current reflection of the General Office Allocation.[12] The Company proposed the 2.8 percent allocation factor as a compromise and to help minimize issues, even though it results in a lower rate base and lower rates.[13]

B. Income Statement.

1. Rate Case Expense.

The Company has accepted Staff's recommendation that rate case expense for the appeal and remand be limited to $100,000; therefore, there is no longer any dispute on the amount of recovery for the appeal and remand between Staff and Chaparral City. There remains, however, disagreement over the amount of rate case expense for this case and over whether rate case expense should be amortized, consistent with established Commission practice, or normalized, as Staff asserts in this case, as explained below.

a. Recovery of Rate Case Expense Related to This Case.

Staff's recommendation that rate case expense for this rate case be limited to $150,000 is unreasonable due, among other things, to the amount of rate case expense authorized in the Company's prior case ($285,000) and the additional expenses the Company was forced to incur in this case due to Staff's last-minute substitution of cost of capital witnesses. According to Staff, its recommended level of rate case expense is appropriate because it "believes that this amount of rate case expense is similar to

[10] Staff Br. at 6.

[11] *Id. See also* Bourassa Rb. at 10-11.

[12] Coley Dt. at 17.

[13] Bourassa Rb. at 10-11.

amounts the Commission has allowed comparable sized utilities to recover through just and reasonable rates."[14] Unfortunately, Staff failed to identify any of these comparable utilities, or to otherwise show that the Company's requested rate case expense in the amount of $280,000 is unreasonable. Instead, Staff's witness relied upon some unspecified rate cases for electric companies in Kansas in the mid-1990s, and his "professional" belief that rate case expense should never exceed $150,000.[15] In contrast, the Company relied on prior Commission decisions for comparable utilities, including, most notably, the Company's last rate case decided three years ago in which Chaparral City was awarded rate case expense equal to $285,000.[16] Thus, Staff fell woefully short of meeting the burden of proof necessary to sustain its recommendation.

As noted above, Staff and the Company also disagree on the manner in which rate case expense should be recovered. Specifically, Staff argues that rate case expense should be "normalized," not "amortized," in order to "flatten the effects of expenses that fluctuate from year to year."[17] At first blush, this might seem more form than substance. Unfortunately, it isn't the case. To begin with, rate case expense is not a normal operating expense. Rate case expense is incurred outside the test year for the specific and limited purpose of obtaining rate relief.[18] Furthermore, Staff's attempt to shift the

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[14] Staff Br. at 8.

[15] Ex. A-14; Tr. at 395-96, 398.

[16] Bourassa Rb. at 26.

[17] Staff Br. at 8.

[18] Tr. at 399; Bourassa Rb. at 22-23.

Commission from a long history of amortizing rate case expense[19] to normalizing it is nothing more than a means to deny utilities full recovery of rate case expense if they seek rate relief before full recovery of rate case expense has occurred. Given the effects of regulatory lag, this is simply unfair. If an expense is determined by the Commission to be reasonable, the Company should not have to face some predetermined and artificial means of denying full recovery, which is exactly what Staff is seeking in this case.

Instead, rate case expense should be treated as a deferred regulatory asset, with an amortized amount included in the Company's income statement.[20] In the alternative, if the Commission is concerned about over-recovery, then the Commission should adopt a surcharge for rate case expense that is authorized for recovery. The surcharge would cease when the authorized amount of rate case expense is recovered. This method would allow the Commission to ensure that utilities neither under- or over-recover rate case expense. The answer, however, is not to "normalize" rate case expense, which conflicts with prior Commission practice and will make it more difficult for utilities to actually recover the expenses they have incurred and been authorized to recover.

b. Recovery of Rate Case Expense Related to Chaparral City's Prior Case.

In its initial brief, the Company agreed to accept Staff's recommended amount of rate case expense, $100,000, for the Company's successful appeal of Decision No. 68176 and the remand proceeding ordered by the Court of Appeals. It should be emphasized,

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[19] Tr. at 400-401. Recent decisions in which the Commission amortized rate case expense include, but are certainly not limited to, *Arizona-American Water Company*, Decision No. 69440 (May 1, 2007), *Arizona-American Water Company*, Decision No. 70209 (March 20, 2008), *Arizona-American Water Company*, Decision No. 70351 (May 16, 2008), , *Far West Water and Sewer Company*, Decision No. 69335 (February 20, 2007), *Black Mountain Sewer Corporation*, Decision No. 69164 (December 5, 2006); *Arizona Water Company*, Decision No. 68302 (November 14, 2005); *Chaparral City Water Company*, Decision 68176 (September 30, 2005).

[20] Bourassa Rb. at 23.

however, that this amount is substantially less than the Company's actual expenses, and illustrates again the Company's desire to be reasonable and minimize issues in this case.

In its initial brief, the Company recommended that the additional rate case expense for the appeal and remand be recovered by means of a surcharge. Having again considered the appropriate method of recovery, and in order to simplify the issues in this case, the Company will agree that the additional rate case expense, $100,000, be added to the amount sought for this case, $280,000, resulting in total rate case expense of $380,000. That amount would be amortized over three years, resulting in an annual expense of $126,667. Concurrently with the filing of this brief, the Company has filed corrected final schedules reflecting this change, as well as the Company's decision to accept Staff's recommended amount.[21]

The foregoing change is, however, based on the Commission's amortization of rate case expense over three years. In the event that the Commission deviates from its prior decisions and "normalizes" rate case expense, then the Company requests that its rate case expense be recovered by means of a surcharge to ensure that recovery actually occurs.

2. Normalization of Expenses.

As explained in the Company's closing brief, Staff's proposal to average Chemical Expense and Repairs and Maintenance Expense is not based on a known and measurable change to the test year.[22] Moreover, Staff could not identify any "extenuating" circumstances that justified abandonment of the test year level of Repairs and Maintenance Expense.[23] With respect to Chemical Expense, Mr. Millsap claimed to have

[21] When the Company's final schedules were filed on January 16, 2009, the Company had not reduced the amount of its rate case expense for the remand from $258,000 to $100,000. The corrected final schedules also reflect that reduction.

[22] Bourassa Rb. at 31-32; Ex. A-12.

[23] Tr. at 386.

found some late-in-the-year invoices for chemicals, which he assumed were for purchases outside the test year. However, he did no analysis whatsoever to confirm this to be the case.[24] Even worse, Staff ignored evidence that Chemical Expense has increased due to increased costs for the chemicals used by the Company and shipping, as well as evidence that the costs were continuing to increase post test year.[25]

In its brief, Staff offers the same cursory arguments to support averaging of expenses found in its prefiled testimony and further exposed through cross-examination. This is insufficient. Boiled down, Staff recommends that the Commission throw out test year expenses and substitute expense levels based on assumptions and the subjective opinions of its witness. Furthermore, such assumptions are based on expense levels that predate the test year and are now 4 to 5 years removed from the date the rates will go into effect. As such, Staff's recommendation undermines the Company's opportunity to earn its authorized rate of return, and should be rejected.[26]

II. REPLY REGARDING ISSUES IN DISPUTE WITH RUCO

A. Rate Base.

1. FHSD Settlement Proceeds.

First, RUCO joined in the Company's recommendation that the proceeds from the FHSD settlement be shared equally between the Company and its ratepayers.[27] Then, RUCO adopted Staff's original position that the proceeds should not be shared equally.[28]

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[24] Tr. 384-88.

[25] *Id.* *See also* Hanford Rb. at 8.

[26] Chaparral City does not oppose Staff's adjustment to remove $5,543 for the costs of beverages provided to its employees. *See* Staff Br. at 9-10.

[27] Coley Sb. at 18.

[28] *Id.*

Next, Staff changed its position for policy reasons.[29] Now, RUCO argues that the proceeds cannot be shared equally between the Company and its customers as a matter of law.[30] RUCO's "legal" arguments are without merit.

RUCO relies on the United States Supreme Court decisions in *Bluefield Waterworks* and *Hope Natural Gas*.[31] Unfortunately, RUCO provides no specific citation to these decisions and fails to explain how these two decisions apply in this case. In *Bluefield Waterworks*, the Supreme Court held, first, that the rate base used to set rates was unlawful because the commission failed to give proper consideration to the reproduction cost study submitted by the utility and instead relied on original cost.[32] The Court also held that that a "public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties."[33] In *Hope Natural Gas*, the Supreme Court adopted what is called the "end result" test, holding that "[i]f the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry . . . is at an end. The fact that the method employed to reach that result may contain infirmities is not then important."[34]

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[29] Tr. at 351-52. RUCO has misrepresented Staff's position. RUCO Br. at 10 ("Staff concurs that the ratepayers should receive the full benefit of the settlement"). Obviously, this is not Staff's position as Staff's brief makes clear. Staff Br. at 2-3.

[30] RUCO Br. at 9.

[31] *Id.*

[32] *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679, 684-92 (1923).

[33] *Id.*, 262 U.S. at 692-93.

[34] *Federal Power Comm'n v. Hope Natural Gas,* 320 U.S. 591, 602 (1944). Notably, the Arizona Supreme Court has rejected the application of *Hope Natural Gas* in Arizona. *See, e.g., Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 150-51, 294 P.2d 378, 38-82 (1956).

In short, neither *Bluefield Waterworks* nor *Hope Natural Gas* stand for the proposition that a utility cannot share the proceeds of a settlement with its ratepayers. RUCO has failed to cite any law, court or public utility decision, rule, regulation, or accounting standard to support its position.[35] Actually, it appears that the only applicable guide is the Commission's decision in Arizona Water Company's Eastern Group rate case, Decision No. 66849 (March 19, 2004), which decision was relied upon by Chaparral City.

RUCO attempts to distinguish this case asserting that there was no evidence in that case that Arizona Water's wells were fully depreciated when they were contaminated by mining activities.[36] There is also no evidence that Arizona Water's impaired wells weren't fully depreciated.[37] In any event, the Commission did not base its decision on the depreciated status of the wells. The Commission's decision to adopt RUCO's position in the Arizona Water case that the settlement proceeds should be equally shared between the Company and its customers was based on the agency's desire to support a public policy that would motivate utilities to take steps to protect the interests of both the utility and its ratepayers.[38] Adoption of RUCO's position would be directly contrary to this reasoning. It would also be patently unfair. The Company acted in the public interest by protecting its interests and those of its ratepayers and turning two aged wells, one of which was never in service, into cash, and seeking to share those proceeds with its ratepayers. An equal sharing of the settlement proceeds is equitable and should be approved.

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[35] Mr. Millsap, upon whom RUCO continues to rely despite Staff's position, also failed to offer any support for his initial recommendation. *See* Millsap Dt. at 11-15; Millsap Sb. at 2-3.

[36] RUCO Br. at 9-10.

[37] Tr. at 266-67.

[38] Decision No. 66849 at 33.

2. Treatment of Acquisition of Additional CAP Allocation.

Staff and Chaparral City are in total agreement regarding the ratemaking treatment related to the Company's acquisition of an additional 1,931 acre-feet allocation of CAP water.[39] This is true with respect to both recovery of the costs of the acquisition through rate base treatment and recovery of one-half of the annual CAP M&I costs as an operating expense. Staff's support for cost recovery is summed up in the following passage from its brief:

> Staff believes that CCWC has acted prudently in the purchase of the additional CAP allocation. Reallocation of CAP water occurs infrequently, and because the CAP water is oversubscribed, it becomes imperative to secure an allotment when it is available. CAP reallocations have to be taken as a whole–it is an all or nothing situation. Also, the additional allotment of 1,931 feet acre will allow CCWC to limit, or eliminate the use of groundwater to service its customers. The combination of these factors fostered Staff's belief in the prudency of the purchase of the additional CAP allotment.[40]

Although it admitted to conducting no engineering analysis, RUCO does not agree that the Company should be authorized cost recovery because it does not believe the additional CAP allocation is used and useful.[41] However, RUCO has not offered any legitimate reason to reject the recommendations of Staff and the Company.

First, RUCO argues that the Company never paid for the additional CAP allocation.[42] This position was not advanced by any of RUCO's witnesses in prefiled

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[39] *Compare* Company Br. at 10-13 *with* Staff Br. at 3-4.

[40] Staff Br. at 3 (footnotes omitted).

[41] In its brief, RUCO argues against any recovery of the costs of the additional CAP allocation. RUCO Br. at 2,14. However, RUCO's Final Schedules filed January 16, 2009, mirror RUCO's surrebuttal position on this issue, which was that 50% of the cost of the CAP allocation should be included in rate base. *Compare* RUCO Surrebuttal Schedule TJC-1 *with* RUCO Final Schedule TJC-1. Thus, it would appear that RUCO has again changed its mind on this issue.

[42] RUCO Br. at 2-3.

testimony or in testimony during the hearings, perhaps because it is really quite silly. As Mr. Hanford, the Company's District Manager clearly explained, Golden State Water is also a subsidiary of the sole shareholder, American States Water, and thus an affiliate of Chaparral City. Mr. Hanford was unaware why CAWCD was paid with a Golden State check, but his testimony that proper accounting entries were made to reflect that funding for the acquisition of the additional CAP allocation was provided to Chaparral City by its shareholder is undisputed.[43]

Second, RUCO argues that the Company does not need the additional CAP allocation because it has a Designation of Assured Water Supply issued by ADWR.[44] In other words, RUCO argues that Chaparral City can pump more groundwater to serve its customers. Apparently, RUCO disagrees with the State's goal of conserving Arizona's limited groundwater resources, a goal this Commission has actively supported.

Third, RUCO argues that the Company's growth projections reflect that the Company does not need all of the additional CAP allocation in the near future.[45] Again, RUCO misses the point. Unlike RUCO's bean-counters, Chaparral City does not have the luxury of looking only at the test year and the next few years. As Mr. Hanford so eloquently explained the decision to spend $1.28 million on the additional CAP allocation:

> I think you have to look at time frames. As a water utility operator, we don't think in months or days or years. We think in decades or centuries. And it's not the water being necessarily available this instant or the next instant. What is in the best long-term interests of our customers?
>
> Again, we live in the middle of the Sonoran Desert. Southern Nevada Water Authority is spending a billion dollars

[43] Tr. at 136.

[44] RUCO Br. at 3.

[45] RUCO Br. at 3-4.

> in a race to lower their Lake Mead intakes before the Colorado River drops so low they can no longer pump Lake Mead water to Las Vegas. A billion dollars. They're spending $6 to $8 billion on a water importation scheme project from eastern Nevada to supply Clark County. Judge Wagner in California cut Metropolitan Water District's allocation by a third with a stroke of a pen. By a third, southern California has less water from the Central California Project. He may reduce it again to half.
>
> We just live in such an age of uncertainty and consequences that we need to plan and think very long-term. It is correct we have not experienced yet a curtailment of our CAP supply. That doesn't mean that it couldn't happen sometime in the future.
>
> This CAP allocation was available once. This was years if not decades of litigation and settlement that was pounded out at the federal government level to resolve three major, contentious legal water supply issues in the Southwest. If we didn't take advantage of this one-time, one-shot opportunity, it would never have been available to us again. And that amount of water we received was not divisible. It was all or nothing, here is the package, take it or leave it.[46]

The Company now faces another "take it or leave it" proposition in this case. If the Commission does not afford reasonable cost recovery, it is unlikely that Chaparral City will be able to keep this prudently-acquired right to renewable surface water. The Company's shareholder is not a charity; it has made an investment and it expects a return on that investment now, not at some unknown time in the future.[47] Thus, contrary to RUCO's assertion, it is "imperative" that the Commission authorize recovery now, in this rate case, in order to protect the long-term interests of the Company's ratepayers.[48] Unlike RUCO, the Commission surely understands that ratepayer interests do not begin and end with the rate paid for utility service.

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[46] Tr. at 131-32.

[47] Hanford Dt. at 7; Hanford Rb. at 6-7; Sprowls Rb. at 5.

[48] RUCO Br. at 6.

Fourth, RUCO argues that the Company does not need the allocation to create a "drought buffer" because it can just use its lost or unaccounted for water.[49] However, as RUCO acknowledges, the Company's test year unaccounted water "was not due to leaks, broken mains or maintenance issues."[50] Staff's engineer testified that Chaparral City is well-operated, well-maintained and well-managed, and that the Company is not ignoring "water loss" issues.[51] As Mr. Hanford explained, this is not an issue of "water loss," but is non-account water likely resulting from a faulty CAP meter, an issue that the Company is seeking to resolve with CAWCD.[52] Mr. Scott accepted the Company's explanation, and echoed that the Company is seeking to resolve the issue.[53] But resolution of the metering issue leading to the high test year unaccounted water will not result in any additional wet water for Chaparral City to use to serve its customers.[54]

Fifth, and finally, RUCO argues that the Company acquired the allocation for the benefit of the Arizona State Land Department and a subdivision developer.[55] This desperate claim by RUCO must be rejected. To begin with, RUCO has misrepresented the record. Mr. Scott did not testify that this was the only reason that the Company's allocation is used and useful; he cited the possible expansion of the Company's CC&N as one of several factors Staff considered.[56] And nothing in the Company's explanation of the acquisition relates to a future subdivision that may, at some unknown future date, be

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[49] RUCO Br. at 5-6.

[50] *Id.*

[51] Tr. at 312, 319.

[52] Tr. at 38, 127-131.

[53] Tr. at 318.

[54] Tr. at 130-31.

[55] RUCO Br. at 7.

[56] *Compare* Tr. at 337-38 *with* RUCO Br. at 7-8.

built on the adjoining property that the State Land Department sold a few years ago to raise money for the public benefit.[57] Of course, should the landowner develop the adjoining property, the Company would be able to further expand the customer base from which it must recover its cost of service, as well as collect hook-up fees, which will be treated as contributions in aid of construction. Thus, existing ratepayers would actually benefit from the potential expansion of the Company's CC&N, should it occur someday.

In summary, the Commission should approve the relief recommended by Staff and the Company, and in doing so, reiterate its support for proactive efforts by public service corporations to protect the long-term interests of ratepayers, as well as the State's precious groundwater resources. As for RUCO, after changing its position back and forth and back again in this case, it has yet to establish a legitimate basis for denying the Company cost recovery with respect to its acquisition of the additional CAP allocation.

3. Amortization of CIAC.

The Company and Staff agree regarding the amortization of CIAC. RUCO doesn't, and claims that the Commission established a CIAC amortization rate on a going-forward basis in the last rate case that the Company must utilize in this case.[58] But the Commission did not authorize a specific CIAC rate in Decision No. 68176, and RUCO's reference to Decision No. 68176 does not reveal otherwise. In fact, the Commission normally does not authorize specific amortization rates when account-specific depreciation rates are used.[59] Additionally, while RUCO's adjustment involves only a $1,500 increase in the CIAC balance, the recommended adjustment will create a

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[57] RUCO's entire discussion of the possible expansion of the Company's CC&N to a proposed subdivision on property formerly owned by the State Land Department is unsupported by the record, which explains RUCO's inability to cite to the record in support of its arguments this section of its brief.

[58] RUCO Br. at 13, *citing* Decision No. 68176 at 15.

[59] Bourassa Rj. at 10-11.

mismatch between plant-in-service and CIAC, distorting the Company's rate base now and on a going-forward basis.[60] For these reasons, RUCO's adjustment should be rejected.

B. Income Statement.

1. Property Tax Expense.

Staff and the Company determined property tax expense using the same methodology that has repeatedly been approved by the Commission.[61] In opposition, RUCO argues, as it has many times before, that the Commission should follow the ADOR methodology to determine a level of property tax expense.[62] However, the Commission does utilize the ADOR formula in the determination of property tax expense.[63]

RUCO's argument, that the Commission should abandon this established methodology because the Company over-recovered property taxes after the last rate case, should also be rejected. First, Chaparral City has never earned the revenue requirement approved in Decision No. 68176. Consequently, any argument that the Company has over-earned is illusory.[64] Second, as RUCO finally acknowledges in its brief, the approved level of property tax expense differed from the amounts actually assessed due "in great part" to the change in the tax rate and tax assessment ratio, not due to a methodology problem.[65]

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[60] *Id.*

[61] Company Br. at 16 and 16, n.4; Staff Br. at 10-11.

[62] RUCO Br. at 12.

[63] *See, e.g.,* Decision No. 68176 at 13.

[64] *E.g.,* Sprowls Rb. at 3-4.

[65] RUCO Br. at 12.

Given these defects in RUCO's arguments, its opposition to the determination of property tax expense should again be rejected in favor of the Commission-established methodology employed by Staff and Chaparral City.

2. Rate Case Expense for Appeal and Remand.

RUCO opposes recovery of any amount of rate case expense for the appeal and remand of Decision No. 68176 arguing, among other things, that recovery should be denied on the basis of "public policy."[66] According to RUCO, rewarding the Company with rate case expense for an action that benefits its shareholders would "encourage a lack of restraint and undermine the appropriate analysis of the risks and benefits of litigation" for the reason that utilities will have "no worry of the costs associated therewith because captive ratepayers will pick up the tab."[67] This argument is specious and reflects RUCO's lack of knowledge about operating a business in the real world. First, a utility has no expectation of recovery unless it prevails in its appeal. Therefore, the same risk-benefit analysis that the Company went through before appealing Decision No. 68176 would take place, regardless of whether costs can be recovered. Second, even if the utility is successful on appeal, full recovery of rate case expense is unlikely, as this case demonstrates.[68] Therefore, at best, a utility may recover a portion of the costs it incurs in challenging a decision. It will not be made whole, as RUCO suggests.

RUCO also argues that the Commission is legally precluded from awarding rate case expense pursuant to A.R.S. § 12-348.[69] For starters, RUCO's argument is disingenuous. The Company sought recovery of this rate case expense in the remand proceeding. RUCO never argued that it was unlawful for the Commission to award rate

[66] RUCO Br. at 11.

[67] *Id.*

[68] *See* Hanford Rb. at 10.

[69] RUCO Br. at 10.

case expense for the appeal and remand. This is true despite the fact that Staff initially argued that A.R.S. § 12-348 "prevents a utility ... from recovering attorneys fees related to an appeal of a rate order."[70] In fact, RUCO didn't oppose the Company's request for recovery of rate case expense in the remand proceeding in any manner.[71] Then, when the Commission shifted the issue to this docket, RUCO asserted only that the Company should receive no rate case expense for the appeal and remand because Chaparral City made a "business decision" to appeal Decision No. 68176.[72] Put bluntly, RUCO's reincarnation of Staff's legal argument is little more than a desperate attempt to deprive the Company of reasonable recovery of rate case expense for the successful appeal and subsequent remand.

RUCO is also wrong. As Staff conceded in the remand proceeding, A.R.S. § 12-348 is not applicable, and the Commission is free to award rate case expense for the appeal and remand.[73] A.R.S. § 12-348(A) provides that "a court shall award fees and other expenses to any party other than this state or a city, town or county which prevails by an adjudication on the merits" in a number of different types of court proceedings, including a "court proceeding to review a state agency decision pursuant to ... [a] statute authorizing judicial review of agency decisions." (emphasis added) Thus, under this statute, a utility recovers its attorneys' fees and other costs when it prevails in an action challenging a Commission decision. Notably, the utility would recover its fees and costs directly from the Commission, not from the utility's customers through rates and charges for service. However, A.R.S. § 12-348(H)(1) excludes actions "to establish or fix a rate." Consequently, while the Commission could be ordered by the court to pay Chaparral

[70] Direct Testimony of Ralph C. Smith, Docket No. W-02113A-04-0616 at 20 (August 30, 2007).

[71] Tr. at 218.

[72] Rigsby Dt. at 1-9; Tr. at 202-245.

[73] Staff Reply Brief, Docket No. W-02113A-04-0616 at 12, (March 21, 2008).

City's fees and costs if the Company had successfully challenged a Commission decision involving its certificate of convenience and necessity or a service-related matter, for example, Chaparral City could not receive an award of fees from the court for successfully appealing Decision No. 68176.

From a practical standpoint, the exclusion of rate cases (but not other types of Commission proceedings) only makes sense if the Legislature was aware that utilities normally recover their fees and costs in prosecuting rate cases as rate case expense, including the cost of any related legal proceedings. In contrast, RUCO's interpretation would allow the Commission to act unlawfully in a rate case, as it did in Decision No. 68176, and the utility would have no means of recovering the additional rate case expense it was forced to incur as a result. That is unlikely to be the policy of the Legislature. It is certainly inconsistent with the remedial purpose behind the balance of the statute, which permits recovery of fees and costs from the Commission in other types of cases.[74]

Accordingly, and for the reasons discussed in the Company's closing brief (at 22-24), the level of rate case expense recommended by the Company and Staff for the appeal and remand is reasonable and should be authorized.

III. REPLY TO BRIEF BY PACIFIC LIFE

Intervenor Pacific Life failed to timely prefile testimony or to otherwise meaningfully participate in this rate case. Despite this, Pacific Life now seeks substantive relief from the Commission, raising four arguments in its brief to support its claims. Each of these arguments is addressed below.

A. The Irrigation Rate Increase Was Adequately Noticed.

The form of notice sent out by the Company was ordered by the ALJ.[75] That the

[74] *See Roubos v. Miller*, 214 Ariz. 416, 419, 153 P.3d 1045, 1048 (2007).

[75] Procedural Order dated July 24, 2008.

Commission has required alternative forms of notice in other rate cases is irrelevant.[76] The Company did what it was ordered to do in this rate case.

The notice, which was published on August 6 and August 13, 2008, imparted upon Pacific Life the knowledge that the Company was seeking to increase its rates for water utility service to all customers. Although the notice did not specify the magnitude of the increase to every customer class, it invited interested persons to intervene, which Pacific Life did. As an intervenor, Pacific Life had an obligation to familiarize itself about the rate increases being sought by the Company, just like the other parties to this case. Pacific Life also had the opportunity to conduct discovery and to prefile testimony. Pacific Life elected not to do so.[77]

Although Pacific Life would now have the ALJ and Commission believe it was unable to protect its interests because it obtained no notice of the precise magnitude of the increase proposed for irrigation customers, the record shows that this allegation is not true.[78] As Pacific Life admits, discussion of the increases in specific rates for specific customer classes was set forth in the Company's filing in the direct testimony of its accounting witness, Thomas J. Bourassa.[79] Mr. Bourassa specifically testified to the Company's proposed increase in the irrigation rate, including the reason for the more significant increase relative to the Company's residential rate class.[80] Mr. Hanford's direct testimony, also filed in September 2007 as part of the application, further addressed

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[76] Pacific Life Br. at 2-3.

[77] Although the notice went out roughly four months before the hearing, Pacific Life waited until the last day to intervene, and did nothing to seek additional time until after the hearings were held in December, 2008. Pacific Life had sufficient time to act. It just chose not to do so until it was too late to do so without prejudicing the rights of the Company and other parties.

[78] *Id.*

[79] *See* Pacific Life Br. at 2.

[80] Bourassa Dt. at 23.

the Company's requested change in the irrigation rate.[81] Put bluntly, in this light, Pacific Life's criticism of the Company is entirely without merit.[82] The Company clearly identified its request in its application, which included direct testimony and schedules. The only thing deficient was Pacific Life's effort to take advantage of the due process it was afforded.[83]

B. There is No Evidence that the Rate Shift Could Devastate Golf Course and Residential Users.

This claim by Pacific Life is unsupported by any evidence in the record before the Commission. There are two possible explanations for this lack of evidence–either the evidence does not exist, or it is not part of the record because Pacific Life failed to avail itself of the opportunity to present evidence. Either way, the argument is of no account.[84] The discussion in its brief is little more than an effort at testimony after-the-fact by Pacific Life and its counsel, and the Company cannot be required, nor should it be expected to address these unsupported and self-serving assertions.

C. Decision No. 68176 Is Not Dispositive.

To begin with, Pacific Life's citations to Decision No. 68176 establish nothing more than that the Company proposed increasing the irrigation rate relative to the residential rate as part of its rate design, that some golf course owners complained during public comment, and that the Commission ultimately adopted Staff's rate design.[85]

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[81] Hanford Dt. at 7-8.

[82] Pacific Life Br. at 3, n.2.

[83] *See* Procedural Order dated December 24, 2008 at 4-5.

[84] Pacific Life's assertion that others might have participated and presented evidence to oppose the proposed irrigation rate is rank speculation belied by the fact that adequate notice was given and no other intervention was sought at any time through this docket's long-history. Pacific Life Br. at 4.

[85] Pacific Life Br. at 6.

Pacific Life does not offer any reason that the Company could not again raise the issue in this rate case for the Commission's consideration. As Mr. Hanford explained, the Company felt that the failure to set the irrigation rate higher in Decision No. 68176 was an "apparent anomaly" given that the Commission adopted Staff's invented tier rate design, which requires larger water users to pay more to promote conservation.[86] Given the Commission's rationale for adopting Staff's proposed rate design in Decision No. 68176, the Company raised this issue in this case to both promote conservation and ensure that its remaining customers (who are paying higher rates for water use) are treated fairly.[87] The Commission is, of course, free to reject the Company's rate design and continue to allow irrigation customers to pay less than other customers.

D. <u>A Cost-of-Service Study Is Not Required.</u>

As stated, the Company is not asking to change its rate design in this case. Rather, Chaparral City sought to address what appeared to be an anomaly in its rate design given the Commission's decision to adopt Staff's inverted tier rate design to promote water conservation.[88] This rate design was not based on cost-of-service principles. Instead, it was based on Staff's desire to promote long-term conservation.[89] Staff's rate design was adopted by the Commission in that case for the same reason.[90] Therefore, Pacific Life's unsupported assertions concerning the need for a cost-of-service study are irrelevant[91] because the Company's current rate design is not based on a cost-of-service study.

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[86] Hanford Dt. at 7-8.

[87] *See* Decision No. 68176 at 30-31.

[88] Hanford Dt. at 7-8; Bourassa Dt. at 23.

[89] Decision No. 68176 at 29-30.

[90] *Id.* at 30-31.

[91] Pac. Life Br. at 6-8.

E. Conclusion Regarding Pacific Life.

As explained, Chaparral City raised the rate structure for irrigation (and construction) water service because that rate design is inconsistent with the inverted tier rate design adopted in Decision No. 68176 to promote water conservation. Staff also proposed a larger increase in the irrigation rate relative to the rates for residential and commercial service, albeit a more gradual increase as compared to the Company's proposal.[92] The Company's overriding concern is that, regardless of the rate design the Commission ultimately approves, such rate design must allow for the recovery of the Company's revenue requirement. Nevertheless, Chaparral City believes that the Commission should consider whether it is appropriate to impose inverted tier rates on residential and commercial customers, while allowing irrigation customers to purchase potable water for landscape irrigation at a rate that is substantially below the initial (lower) rate applicable to other customers. Such a rate is contrary to the premise of the overall rate design ordered in Decision No. 68176.

IV. CONCLUSION

For the foregoing reasons, and for the reasons set forth in Chaparral City's initial closing brief, Chaparral City respectfully urges the Commission to authorize an increase in revenue of $2,852,353, which would allow the Company to earn a 9.96 percent return on the fair value of its utility plant and property devoted to public service as of December 31, 2006, and for such other further relief as may be required to provide the Company with a reasonable opportunity to actually earn such rate of return.

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[92] Tr. at 403.

RESPECTFULLY SUBMITTED this 13th day of February, 2009.

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